

3 – Reasons for a Reform

With the '90s the situation became untenable. The Maastricht Treaty signed in February 1992 set a goal – the single currency – and some convergence criteria to be met in order to be part of the new monetary system.

For a while in Italy there was uncertainty whether to be “in” – that is in the group of the first entrants – because almost everybody thought that it was impossible to meet the criteria. Eventually the decision was taken to make any effort in order to be part from the very beginning of the Economic and Monetary Union.

To many decision makers – both in the political and economic sectors – one very important argument behind this decision was the possibility of proposing and enacting unpopular reforms under the justification of the EMU: Europe was used as an external pressure in order to break political and social opposition to change.

Many were the causes of the public deficits and mounting public debt. Some of them were of a general, national nature and possible solutions did not involve any kind of decentralisation or federalism. Others on the contrary were linked to the characteristics of the Italian administrative and political set-up. We are specifically interested in these and will present them briefly.

3.1 – Local Government Financial Accountability

One of the factors causing public deficits was the quite peculiar situation of regional, and more generally local, governments: they were given many responsibilities by the mere activation of all the provisions listed in the Italian *Costituzione*. In order to fulfil these duties Italian regions did not have any relevant taxation power and relied on transfers from the central government; at the same time the budget constraints were very soft because almost every time their deficits were covered by additional resources granted by Rome, the central government.

In many cases there was a perverse incentive to spend more and more because transfers were determined on a historical basis: so the biggest spenders were also the biggest receivers. Almost no fiscal responsibility existed, regions could spend without any economic or political cost: they were not required to make their citizens pay for the services received.

The result was even worse because the implementation of the regional government reform coincided with the fiscal reform - which abolished almost all local revenue sources.

By the beginning of the '90s this anomaly became so evident that a vast majority was in favour of abolishing it and making regions more accountable to their citizens. Of course there were groups or local authorities that were very lukewarm about any change: after all it was quite convenient to provide services and protest against central government taxation. In addition some regions feared the inevitable reduction in resources, being rather poor. Moreover the prospect of fiscal competition between regions was rather new to everybody and costs seemed bigger than benefits.

Eventually the Italian Parliament had to pass legislation setting specific constraints on local and regional governments' deficits (the so-called "internal stability pact").

3.2 – Efficiency in the Local Public Sector

The Italian public sector expenditure is not (and was) out of line with most countries of the (now) European Union - contrary to a commonly held view. The real problems were on the one hand public deficits and on the other hand the inefficiencies of the bureaucracy and the low quality of the services provided.

The first problem dates back many decades and is due to the rather low wages and salaries paid to civil servants (at least compared to the private sector payments) and to the selection and training processes: the former was biased by political patronage and the second almost non-existent.

In addition the main responsibility of a bureaucrat was supposed to be the interpretation of law and by-laws, very often quite complex and ambiguous, not the implementation of given policies.

With time the influence of the trade unions grew and it became almost impossible to discipline any bureaucrat even guilty of rather serious crimes: this was widely accepted by people and institutions involved because it made void the idea of personal responsibility.

The general public had very few chances of getting redress from inefficient - or even unfair – behaviour of a civil servant.

The quality of the services produced by the public sector was generally quite low. Here too there was little that could be done: competition by private producers was difficult or prohibited, even if people ingenuity was sometimes able to make the difference.

The situation was quite similar for the central and the local governments: the behaviour of the two did not differ in a significant way because the kind of controls and political pressure by citizens were almost the same. Of course there were a few "islands" of efficiency concentrated

mainly in northern areas of Italy because of the historical tradition of local autonomy and good government.

As some sort of compensation taxation in Italy was lighter than in other European countries and even more tariffs for public goods or services. Evasion too was quite relevant, in particular for some specific groups or taxes: income taxes for self-employed people or VAT in some productive sectors or with small and medium firms.

There was a balance, even if a perverse one: the services are bad but the price one pays is low. For example local (and rail) transports were slow and unreliable but tariffs were very low (trains in Italy were two thirds cheaper than in UK or Germany and one half than in France).

3.3 – Interregional Equalisation

Another problem that became acute during the '80s and the beginning of the '90s was the interregional redistribution of resource operated by the central government.

The most relevant and criticised feature was the huge transfer of resources from the North (and the Centre) to the South of Italy. When budget constraints were soft and growth rates not negligible it did not raise much opposition but with harder times (and a changing political situation – as we shall see in the next paragraph) dissatisfaction grew.

The interregional redistribution was partially justified by the much lower income per head in most Southern areas but the lack of positive effects – the gap did not narrow – was (rightly) interpreted as misuse of the funds due to inefficiency and corruption.

The problem was made more acute by the fact that other kinds of unequitable, or at least unexplainable, transfers happened: from ordinary statute regions to special statute ones, from large regions to small ones – even at similar income per head levels.

The biases could not be explained by the aim of providing every person an equal amount of (public) goods and services.

Other redistributive aspects are quite important – the intergenerational one and the one between social groups. The former operates mainly through state pension schemes and is now at the centre of the political debate. There is a widespread opinion that state pensions are too generous with old workers and recently retired people (in particular female ones) because the prevailing system was a redistributive one and the

benefits were fixed in times when the ratio of retired to active workers was low. With the ageing of the population and longer life expectancy younger generations will have to bear an excessive burden.

The second aspect too is geared against younger generations or better against people asking for a job because labour laws and by-laws protect employed persons against unemployed ones.

These aspects are now quite hotly debated but were not so sensitive up to the beginning of the '90s.

3.4 – Changes in the Political Scene

At the same time the collapse of communist regimes in Soviet Union and other East European countries modified deeply the Italian political scene.

Since mid-'70s many laws were enacted and policies adopted with a large "bipartisan" support: opposition parties voted for (or abstained over) most bills after a quite intense bargaining process that led to some modifications of the original draft proposed by governments. The boundary between government political parties and opposition ones on the left became blurred; the result very often was compromise not reform, delay not action.

At the same time there was some sort of a veto for the (then so called) Communist Party to enter government. With the disappearance of the world bipolarisation between West and East the veto too lapsed.

Politics in Italy became more flexible meaning that there was for the first time after WWII a real possibility of an alternative in government.

A second important element appeared: the rapid growth of many regional parties in the North (the most important area from an economic point of view) among which one based mainly in Lombardy – *Lega Nord* o Northern Alliance - got the greatest support. The main reason for the success of these political parties was a growing dissatisfaction with the inefficiencies of the central government and more specifically with the low quality of the public services and goods provided coupled with the transfer of relevant amounts of resources from the northern regions to the southern ones.

In particular the latter reason played an important role in winning votes for these parties. The '90s saw a reversal of previous attitudes and preferences in European public opinions, from a marked concern for social issues and in particular a more equalitarian personal income distribution to rather individualistic if not selfish behaviours. In many European countries – Germany, Switzerland, among others – richer social groups and regions objected to equalising transfers by central governments.

In Italy this happened simultaneously with the decline of the two main political parties (the Christian Democratic and the Socialist ones) due to bribes and corruption charges, in a quite novel but effective activity by the judiciary in order to make politics cleaner.

The regional political parties became essential in forming local governments in the northern regions and fluctuated between federalism and separatism. They stressed the inefficiencies of the central government and the excessive (in their opinion) transfer of funds from the North to the South. Another hot point they made was the centralisation in rules and bylaws: everything was decided in Rome, in the same way for every part of Italy. The examples of Germany and Switzerland – with large autonomies given to any *land* and canton – were taken as possible solutions for Italy too.

The mere administrative and operational decentralisation was not any more enough.

No political party could neglect this appeal to federalism and decentralisation. The Northern regions make up about 40 % of the population – and votes – and much more of the GDP – and taxes.

The result was a rather deep change in the *Costituzione* giving regions (but not provinces and municipalities) much wider powers. The shift was essentially from a positive list to a negative list: while previously regions could legislate on a given number of problems now they can decide on everything that is not excluded and reserved to the central government.

4 – Decentralisation and Devolution in the Nineties

The reform implemented in the nineties has radically reshaped the finance of both Regions and Municipalities. Here we focus on Regions as they represent at present the main counterpart of the central government in the political debate on fiscal federalism.

4.1 – The Enlargement of the Fiscal Autonomy of Ordinary Statute Regions

At the beginning of the Nineties Ordinary Statute Regions (*OSR*) have basically no fiscal autonomy. Up to 98% of total revenue are transfers from the central government. Further, nearly all of these grants are conditioned to the financing of the National Health Service (*NHS*) (which represents nearly 80% of total regional expenditure) and of other minor expenditure programs.

During the decade there have been several attempts to increase the fiscal autonomy of *OSR*. We can single out two phases in the reform process. In the first phase, the central government introduces the essential